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No. 98-1643

IN THE
Supreme Court of the United States

IN THE MATTER OF: SOUTHMARK CORPORATION,
Debtor.

SOUTHMARK CORPORATION,
Petitioner,

v.

COOPERS & LYBRAND L.L.P.,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONER

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STATUTE

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Respondent's brief in opposition urges this Court to ratify the Fifth Circuit's sweeping vision of the role of bankruptcy courts and to grant these Article I tribunals a broad jurisdiction plainly prohibited by this Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). In advancing this novel theory, Coopers & Lybrand L.L.P. ("Coopers") fails to explain how a bankruptcy court constitutionally forbidden from adjudicating "state-created private rights," *id.* at 71, could have adjudicated Southmark Corporation's ("Southmark's") state-created cause of action for malpractice. Nor does Coopers show how Southmark's action, filed nearly five years after its emergence from bankruptcy, falls within a bankruptcy court's core jurisdiction—a narrow zone which this Court has limited to "the restructuring of debtor-creditor relations." *Id.*

Coopers' brief succeeds only in demonstrating why review of the Fifth Circuit's decision is needed. Under the lower court's reasoning, *any* lawsuit against *any* court-appointed professional automatically falls within a bankruptcy court's core jurisdiction. Such a result not only violates the constitutional limits this Court recognized in *Marathon*, but directly conflicts with the holdings of other courts of appeals that have denied bankruptcy courts the power to adjudicate state-law claims against trustees and other court-appointed professionals.

I. Coopers Fails To Reconcile The Fifth Circuit's Holding With The Jurisdictional Limits Established In *Marathon*

Confronted with an adjudication plainly violative of a bankruptcy court's jurisdictional limits,

Coopers repeatedly invokes its status as a court-appointed professional in an attempt to force this lawsuit into the narrow confines of core jurisdiction. Neither this argument, nor Coopers' reliance on assorted policy goals, can trump the unambiguous mandate of *Marathon*: State-created private rights must be adjudicated by an Article III decisionmaker.

A. Contrary To Coopers' Argument, Lawsuits Against Court-Appointed Professionals Are Not Automatically Core Proceedings

In defending the decision below, Coopers advances the proposition—never before accepted by this or any other court—that state-law tort claims against bankruptcy court-appointed professionals automatically qualify as core proceedings because they "cannot be divorced from the bankruptcy context." Opp. 3. This theory is flatly contradicted by *Marathon*, which held that the core/non-core inquiry is guided by the substantive nature of the asserted right, public or private—*not* by the setting in which the right arises or by the identity of the parties. 458 U.S. at 69-70. If the right is a "state-created private right," it must be adjudicated by an Article III court. *Id.* at 71. *See also In re United States Brass Corp.*, 110 F.3d 1261, 1268 (7th Cir. 1997) (Posner, C.J.) ("Core proceedings are actions by or against the debtor that arise under the Bankruptcy Code in the strong sense that *the Code itself* is the source of the claimant's right or remedy.") (emphasis added).

Coopers does not dispute that the rights Southmark asserts are private rights created by the State of Texas. Nor does Coopers dispute that

resolution of Southmark's claims turns entirely upon state law.[1] Instead, Coopers ignores the substantive nature of these claims and argues that its mere status as a court-appointed professional suffices to trigger a bankruptcy court's core jurisdiction, noting that it owed duties to the bankruptcy court as well as to Southmark. Opp. 3. The flaw in Coopers' argument is simply this: Southmark's malpractice lawsuit did not implicate any duties Coopers owed to the bankruptcy court. The duty Coopers breached was a duty to *Southmark* imposed under Texas law; any duties Coopers may have owed to persons or entities other than Southmark are entirely irrelevant to this proceeding.

Coopers' argument amounts to a claim that Southmark must be divested of its constitutional right to an Article III decisionmaker because Coopers violated its duty to the court in addition to its duty to Southmark. Yet the fact that Coopers violated its duties under the Bankruptcy Code is immaterial to the question whether Southmark is entitled to an adjudication of its state-created rights by an Article III court. In any event, Coopers'

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[1] Coopers' contention that the Bankruptcy Code, 28 U.S.C. § 157(b)(3), somehow encourages bankruptcy courts to determine state-law claims is wholly misplaced. As an initial matter, this subsection merely provides that state-law claims are not *automatically* non-core; if anything, the provision *discourages* bankruptcy courts from deciding matters arising under state law. More important, Coopers' response ignores the central point of Southmark's argument: The jurisdictional limit the bankruptcy court violated by adjudicating Southmark's state-law action was a constitutional rather than statutory limit. Section 157(b)(3) cannot be read to authorize what *Marathon* forbids.

reasoning is impossible to reconcile with this Court's holding in *Marathon*, which recognized that an ordinary tort suit—a private right of action that concerns "the liability of one individual to another," 458 U.S. at 69—*requires* adjudication by an Article III court.

Coopers contends that "ensuring the disinterestedness of court-appointed professionals is essential to the proper functioning of the bankruptcy court and therefore is within the core bankruptcy power." Opp. 4. Even if true, this observation is entirely beside the point. Bankruptcy courts can ensure the disinterestedness of their appointees through a wide variety of sanctions and other policing mechanisms, *see* Pet. 18, yet the availability of these sanctions in no way limits a victimized party's right to seek redress under state law in an Article III court.[2] All the cases cited by Coopers stand for the unremarkable proposition that bankruptcy courts have a duty to ensure that their appointees are in fact disinterested. *See, e.g., Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994). None of the cases recognize the rule Coopers purports to elicit: that the Constitution empowers an Article I bankruptcy court to adjudicate, nearly five years after the bankruptcy proceedings have concluded, a private tort action arising under—and governed by—state law.

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[2] In an analogous context, this Court, in *Business Guides, Inc. v. Chromatic Communications Enters., Inc.*, 498 U.S. 533, 553 (1991), explained that the sanctioning provisions of the Federal Rules of Civil Procedure serve a different purpose than private suits in tort, emphasizing that "we are confident that district courts will resist the temptation to use sanctions as substitutes for tort damages."

Finally, Coopers' attempts to distinguish this Court's rulings in *Marathon* and *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), fall short of persuasive: Coopers suggests that these cases were actually decided on a different basis than the one the Court articulated. According to Coopers, the claims in *Marathon* (breach of contract and warranty, misrepresentation and duress) and in *Granfinanciera* (fraudulent conveyance) were non-core because they "related to pre-petition conduct that possessed neither a temporal nor structural nexus to the bankruptcy process." Opp. 5. Coopers fails, however, to identify any language supporting its revisionist interpretation. This is not surprising: *Marathon* "emphasized that state-law causes of action for breach of contract or warranty are paradigmatic private rights, *even when asserted by an insolvent corporation in the midst of Chapter 11 reorganization proceedings*." *Granfinanciera*, 492 U.S. at 56 (emphasis added). Similarly, the *Granfinanciera* Court likened fraudulent conveyance claims to "state-law contract claims brought by a bankrupt corporation" that were not "integral to the restructuring of debtor-creditor relations." *Id.* at 56, 58. Absent in both of these cases is any suggestion that the holding hinged on the timing of the tortious conduct (pre- or post-petition) or the existence of a "temporal" or "structural" nexus to bankruptcy.

B. Coopers' Defense Of The Decision Below Rests On A Blatant Mischaracterization Of Southmark's Claims

Implicitly acknowledging the impropriety of the bankruptcy court's adjudication of a malpractice lawsuit, Coopers repeatedly mischaracterizes

Southmark's claims as "essentially fee objections." Opp. 7. From this faulty predicate, Coopers reasons that permitting another court to hear Southmark's claim would "seriously undermine the power of the bankruptcy court to control the conduct of court-appointed officers." Opp. 4, 6. This argument echoes the Fifth Circuit's conclusion, Pet. App. 12a, that Southmark's malpractice claim implicates "the court's ability to police the fiduciaries . . . who are responsible for managing the debtor's estate in the best interest of creditors."

Coopers lacks any basis—indeed, it identifies none—for equating Southmark's lawsuit to a claim for fees. Southmark sued Coopers not for disgorgement of fees under the Bankruptcy Code, but under Texas tort law for the $20 million-plus in damages that Southmark claims was caused by Coopers' wrongful conduct, in addition to punitive damages. Coopers' brief fails to acknowledge that a disgorgement proceeding and a malpractice lawsuit vindicate separate and distinct interests. The former vindicates the *public* interest in ensuring that Coopers fulfills its duties to the court; the latter vindicates Southmark's *private* interest in ensuring that Coopers fulfills its duties, as determined under Texas law, to Southmark. By any measure, a malpractice suit is not a disgorgement proceeding, yet Coopers' entire argument depends on their conflation.

Other than its own *ipse dixit*, Coopers offers no basis for concluding that a bankruptcy court's ability to supervise the performance of its appointees would be threatened by denying it jurisdiction to decide malpractice claims. Coopers blithely ignores the arsenal of sanctioning provisions available to bankruptcy courts. *See* Pet. 18. Instead, Coopers

points to *In re Linton*, 136 F.3d 544, 545 (7th Cir. 1998), which merely applied the federal common law rule, recognized for well over a century, that someone wanting to sue a trustee in bankruptcy concerning actions taken by him in the course of his trusteeship must obtain the permission of the bankruptcy court. *Linton*, which does not concern core jurisdiction, is completely inapposite. It does not cite *Marathon*, nor does it even purport to authorize Article I courts to adjudicate matters this and other courts have consistently deemed non-core.[3]

II. Coopers' Own Argument Confirms The Existence And Severity Of The Circuit Splits Regarding Core Jurisdiction

Coopers' insistence that the courts of appeals are in harmony over the question whether core jurisdiction encompasses state-law claims against court-appointed professionals is belied by its own argument. As Coopers explains, the Fifth Circuit concluded that Southmark's claims were core because "without the bankruptcy proceeding, Coopers would have had no relationship with Southmark and the claims would not exist." Opp. 5. This holding cannot be reconciled with the Third Circuit's decision in *Torkelson v. Maggio (In re Guild and Gallery Plus, Inc.)*, 72 F.3d 1171 (3d Cir. 1996). There, the court held that negligence and conversion claims against a Chapter 7 trustee were

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[3] Coopers also relies on *Linton* to suggest that Southmark somehow seeks to make a collateral attack on the result of the disgorgement proceeding. This argument is meritless. As Coopers acknowledges, Opp. 7, Southmark *prevailed* on its motion for disgorgement; Coopers was ordered to pay $585,000.

non-core—even though, under the Fifth Circuit's reasoning, "without the bankruptcy proceeding, [the trustee] would have had no relationship with [the plaintiff] and the claims would not exist." *Guild and Gallery* illustrates the circuit split over when a state-law claim against a court-appointed professional constitutes a core proceeding.[4]

Coopers' attempt to reconcile the Ninth Circuit's decision in *Taxel v. Electronic Sports Research (In re Cinematronics, Inc.)*, 916 F.2d 1444 (9th Cir. 1990), is similarly meritless. Coopers does not contest the court's central holding that claims—even those that arise post-petition—are non-core when they do not "directly affect the estate or the confirmation of the estate's plan," *id.* at 1450. Nor does Coopers dispute that the suit against the debtor's president was deemed non-core, even though the president served with the approval of the bankruptcy court. *Id.* at 1446-47. Instead, Coopers argues, Opp. 12, that the decision is suffused with "ambiguity" that subsequently "evaporated" with the Ninth Circuit's decision in *Walsh v. Northwestern Nat'l Ins. Co. (In re Ferrante)*, 51 F.3d 1473 (9th Cir. 1995). *Ferrante*, however, stands only for the narrow and unremarkable proposition that a proceeding involving a trustee's

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[4] The Third Circuit's prior decision in *Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242 (3d Cir. 1994), is not to the contrary. As Coopers concedes, Opp. 10, the question of core jurisdiction was not raised on appeal and therefore "was not addressed directly by the court." Moreover, the district court's ruling, 150 B.R. 563, rested on the fact that—unlike here—the plaintiffs' claims could not be evaluated without assessing the defendants' duties under the Bankruptcy Code in connection with the reorganization.

embezzlement of estate assets falls within core jurisdiction. The case most assuredly does not suggest that *all* proceedings against court-appointed professionals are core, particularly where, as here, the lawsuit is predicated on state-created rights as opposed to federal duties imposed by the Bankruptcy Code.[5]

A recent decision from the Eleventh Circuit only exacerbates the conflict. In *Continental Nat'l Bank v. Sanchez (In re Toledo)*, 170 F.3d 1340 (11th Cir. 1999), the court held that a lawsuit against a bankruptcy trustee, the debtors, and the bank was non-core. The court explained that—even though the trustee was sued for conduct he performed pursuant to his official duties—the action to determine the validity of liens "did not invoke a substantive right created by bankruptcy law" but concerned "essentially a state-law right based on principles of contract and/or fiduciary duty." *Id.* at 1349 & n.11. The court concluded that because the property in dispute did not belong to the debtor's estate and because the suit "sought to vindicate state-created common-law rights but did not utilize any process specially established by the Bankruptcy Code," it fell outside the scope of core jurisdiction. *Id.* at 1350.

Review by this Court is warranted to resolve the split among the Circuits on this important and recurring question, and to clarify the bounds of core jurisdiction.

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[5] Nor can *Ferrante* be read as overruling *Cinematronics*. "[O]nly a panel sitting en banc may overturn existing Ninth Circuit precedent." *United States v. Camper*, 66 F.3d 229, 232 (9th Cir. 1995).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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